BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
EDWARD B. AND BETTY G. GILLESPIE)

For Appellants: Edward B. Gillespie, in pro. per.

Betty G. Gillespie, in pro. per.

For Respondent: John R. Akin Counsel

OPINION

This appeal is made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Edward B. Gillespie against a proposed assessment of additional personal income tax and penalties in the total amount of $1,746.39 for the year 1975; of Betty G. Gillespie against a proposed assessment of additional personal income tax in the amount of $123.00 for the year 1975; and of Edward B. and Betty G. Gillespie against proposed assessments of additional personal income tax and penalty in the total amounts of $1,324.12 and $2,072.32 for the years 1976 and 1977, respectively.

The first issue to be decided is whether additional tax and penalties were properly assessed against Edward B. Gillespie for the year 1975.

For 1975, Edward B. Gillespie submitted a return which stated that he had income of less than $740.00 in "constitutional dollars" and which listed numerous constitutional objections based on contentions that Federal Reserve notes were not "dollars." Respondent notified appellant that this did not constitute a proper return and demanded that he file a proper return. When appellant did not comply, respondent issued a proposed assessment based on employer information from the Employment Development Department and imposed penalties for 'failure to file after notice and demand, delinquency, negligence, and failure to pay estimated tax.

It is well settled that respondent's determinations of additional tax and penalties are presumptively correct, and the taxpayer has the burden of proving that they are wrong. (Appeal of Michael Mason, Cal. St. Bd. of Equal., March 30, 1981.) Appellant's constitutional arguments are clearly without merit. (See Appeal of Ottar G. Balle, Cal.-St. Bd. of Equal., Feb. 6, 1980.) Since-he has in no way shown that respondent's determinations are wrong, they are sustained.

The next question presented is whether Betty G. Gillespie was entitled to a claimed educational expense deduction for 1975.

Be-tty G. Gillespie filed a separate personal income tax return for 1975 and claimed a $1,800.00 deduction for "students educational fees." She later stated that this expense was incurred to learn how to set up and manage an "equity trust." Respondent issued a proposed assessment reflecting disallowance of this deduction.

On appeal, appellant argues that this expense was related to the conservation and management of property held for income production, apparently contending that it was deductible under Revenue and Taxation Code section 17252. However; expenses for special courses or training are not deductible under that section. (Appeal of Jerome I. and Catherine Bookin, Cal. St. Bd. of Equal., March 26, 1974; Cal. Admin. Code, tit. 18, reg. 17252, subd. (f) (repealer filed April 16, 1981, Reg.

81, No. 16).) The deduction was, therefore, properly disallowed.

The third question presented is whether proposed additional tax and penalties were properly assessed against appellants for the years 1976 and 1977.

On or about December 23, 1975, Edward B. Gillespie (hereinafter "Edward") executed a document captioned "Declaration of Trust of This Equity Trust." The document was a pre-printed form with spaces provided for filling in appellants' names. The trust was styled the "Edward B. Gillespie Equity Trust' with Edward as grantor and Betty G. Gillespie (hereinafter "Betty") and one Joe Dibs as trustees. At some time, Edward also. became a trustee.

The declared purpose of the trust was to accept legal title to all property which the grantor conveyed to it "so that Edward B. Gillespie [could] maximize his lifetime efforts through the utilization of his Constitutional Rights ...." The trust was to be administered by its trustees with a majority vote required for expenditures (including compensation for the trustees). They were to be guided by the Declaration. of Trust, supplemented by resolutions passed to cover contingencies as they arose. The trustees were empowered to do anything with the'trust assets which an individual might do, and a resolution authorizing any action was to be evidence that such act was within their power.

The beneficial interest of the trust was divided into 100 units, evidenced by certificates which were freely transferable. Betty apparently owned 96 percent of the beneficial interest of the trust, and Edward apparently owned 4 percent.

Upon liquidation of the trust, its assets were to be distributed to the holders of the certificates in proportion to their ownership. The trust was to continue for 25 years, but the trustees could, by unanimous vote, terminate and liquidate it at 'any earlier time. The trustees agreed to use their best judgment and discretion to conserve and increase the value of the trust's assets, "making distributions of portions of the proceeds and income as in their discretion ... should be made ...."

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At all times pertinent to this appeal, Edward was employed by Rockwell International Corporation and Betty was employed by McDonnell Douglas Corporation. On their 1976 and 1977 joint personal income tax returns, appellants reported their combined incomes from their employment and otter income which consisted primarily of "consulting fees" from the trust. They then subtracted, as adjustments to income, "payments of nominee income to Edward B. Gillespie Equity Trust" in amounts equal to their income from employment. On fiduciary returns for those same years, the trust listed income or losses from interest, partnerships, rents and royalties, sale of assets, and "other income." This last item consisted almost entirely of the "nominee income" which appellants had subtracted on their personal returns. The trust claimed deductions in both years for unexplained interest, taxes, charitable contributions, and depreciation on the "trust headquarters" (apparently the mobile home in which appellants lived) and personal property conveyed to the trust. Deductions were also claimed for payments of the trustees' personal expenses and for "consulting fees" paid to appellants.

Respondent adjusted apellants' reported income, adding in the trust's income (including the "nominee income" appellants paid to the trust), and subtracting trust distributions to Edward and "consulting fees" paid to appellants by the trust. Notices of proposed assessments were issued which included negligence penalties for both 1976 and 1977.

Respondent contends that the trust had no economic reality and was a nullity for income tax purposes. Alternatively, it asserts that an anticipatory assignment of income is ineffective to shift the tax burden from appellants, and that appellants are taxable on the trust income because it is a grantor trust. Since we agree with respondent's first contention; we need not discuss the alternative arguments.

Appellants have executed a document in the form of a trust. However, it is the substance of a transaction which determines its treatment for income tax purposes. The precepts cited by the Tax Court of the United States in a case involving the federal income tax consequences of a very similar trust arrangement are equally applicable here.

> Technical considerations and legal niceties of the law of trusts which petitioners

> seek to hide behind will not obstruct our view when the sole purpose for this subterfuge is the avoidance.of Federal income tax. To be sure, a taxpayer has the legal right to minimize his taxes or avoid them totally by any means which the law permits. See Gregory v. Helvering, 293 U.S. 465, 469 (1935). However, this right does not bestow upon the taxpayer the right to structure a paper entity to avoid. tax when that entity does not stand on the solid foundation of economic reality. When the form of the transaction has not, in fact, altered any cognizable economic relationships, we will look through that form and apply the tax law according to the substance of the transaction. Furman v. Commissioner, 45 T.C. 360 (1966), affd. per curiam 381 F.2d 22 (5th Cir. 1967). 'It is axiomatic that a deficiency is proper on the ground that 'regardless of regularity of form as a matter of plutological reality, there is no change in economic ownership.' Burde v. Commissioner, 352 F.2d 995 (2d Cir. 1965); Furman v. Commissioner, supra. (Louis Markosian, 73 T.C. 1235, 1241 (1980).)

In the instant case, appellants' relationship to the property and income allegedly transferred to the trust did not differ in any material way before and after the creation of the trust. Appellants lived in the same mobile home as before (until the trust bought a new one for them). They continued in their employments, earning wages as before, the only difference being that appellants as trustees, rather than individually, paid most of their personal living expenses. The funds for these expenses, nonetheless, came from appellants' own wages.

Appellants contend that an independent trustee prevented them from dealing freely with the trust assets. However, there is no evidence that an independent trustee existed after the trust's creation, and, in fact, appellants dealt with the assets in the same manner before and after the creation of the trust.

There were no other beneficiaries under the trust besides appellants. As trustees, appellants had broad powers to amend the trust by resolution "covering contingencies as they [arose]." Their unbridled discretion over the property is apparent in the trust provision making the mere enactment of a resolution adequate evidence that any action taken pursuant thereto was within their power as trustees. These powers, when read together with the extraordinarily broad purposes of the trust, gave appellants the same control over the property and income conveyed to the trust as they enjoyed before the trust's formation. Clearly, there was no change in appellant's economic position.

We can perceive no valid purpose for this trust other than the avoidance of tax. The factors mentioned previously, together with the obvious tax avoidance purpose, are sufficient to cause this trust arrangement to be treated as a nullity for income tax purposes.

Two recent tax court cases have reached the same conclusion in cases involving trust arrangements which were identical to this one in all but a few minor respects. (Louis Markosian, supra; Edward G. Bass, Jr., ¶ 81,146 P-H Memo. T.C. (1981).) Appellants attempt to distinguish one of these cases on a factual basis, but the few differences cited by appellants have no effect on the relevance to thisappeal of the legal principles stated in those cases.

We find that appellant's trust arrangement was founded on meaningless pieces of paper and must be disregarded for income tax purposes. Respondent's action in regard to the proposed additional tax is; therefore, sustained.

The final issue for our determination is whether appellants are liable for the penalty imposed under section 18684 for the years 1976 and 1977. That section imposes a five percent penalty if any part of any deficiency is due to negligence or intentional, disregard of rules and regulations. The taxpayer has the burden of proving that respondent's determination in regard to this penalty is incorrect. (Appeal of Myron E. and Alice Z. Gire, Cal. St. Bd. of Equal.., Sept. 10, 1969.)

Appellants argue that since there had been no administrative or judicial interpretations regarding family trusts at the time they set up their trust, they should not be liable for the neg,ligence penalty. They state that they based their actions on "reasonable and logical interpretations of new law" and should not be penalized for doing so. We d fsagree. Appellants have cited no "new law" upon which they may have relied. The principles on which our decision is founded have been part of the income tax law for many years and were available to appellants when they created the trust had they troubled to investigate. (See e.g., Burde v. Commissioner, 352 F.2d 995 (2d Cir. 1965); Irvine K. Furman, 45 T.C. 360 (1966), affd., 381 F.2d 22 (5th Cir. 1967); Appeal of W. E. Hall Company, Cal. St. Bd. of Equal., Dec. 13, 1961.) Indeed, on the record before us, we find it difficult to believe that appellants envisioned the trust as anything other than a flagrant tax avoidance scheme. The negligence penalty is sustained.

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ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor.,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on'. the protests of Edward B. Gillespie against a proposed assessment of additional personal income tax and penalties in the total amount of $1,746.39 for the year 1975; of Betty G. Gillespie against a proposed assessment of additional personal income tax in the amount of $123.00 for the year 1975; and of Edward B. and Betty G. Gillespie against proposed assessments of additional personal income tax and penalty in the total amounts of $1,324.12 and $2,072.32 for the years 1976 and 1977, respectively, is hereby sustained.

Done at Sacramento, California, this 27th day of October, 1981, by the State Board of Equalization, with Board Members Mr. Dronenburg, Mr. Bennett and Mr. Nevins present.

Ernest J. Dronenburg, Jr., Chairman

William M. Bennett, Member

Richard Nevins, Member

__________, Member

__________, Member